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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 254

ARGONAUT SAVINGS AND LOAN ASSOCIATION, a Corporation, and CITY SAVINGS AND LOAN ASSOCIATION, a Corporation,

Petitioners,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver of San Francisco National Bank,

Respondent,

PETITIONER'S REPLY BRIEF ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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REPLY BRIEF OF APPELLANTS ON PETITION FOR A WRIT OF CERTIORARI

The Respondent's brief (pg. 4) refers to the suit and claim at bar as one for the unexpired term of the lease. Such is not the nature of the suit. The complaint appears in full on pages 1 and 2 of the appendix to the petition. The material parts of the lease are set forth on pages 2-4.

Respondent's brief in the appendix sets forth a letter which is no part of the record in this case, and is contrary to the facts appearing in the record that no rent was paid under the lease for either the months of December 1964 or January of 1965, nor for the period after the receiver took possession on January 22, 1965, until March 2, 1965, when the February rent was paid a month late.

There was therefore a clear breach of the lease almost two months prior to the Comptroller closing the bank and this breach has continued. This default in payment of rent is not in issue in the record.

Respondent's brief correctly states that the lessor assigned the lease on the same day the lease was executed in 1963. The assignment of the lease is recited in paragraph 2 of the complaint and attached as Exhibit "B" to it in the complete record before this court. As such, no payment to the assignor after the notice of the assignment was given could be a credit nor could there be any offset against the assignor. The fact is and Exhibit "B" to the complaint shows that the bank consented in writing to the assignment and therefore had notice.

Respondent's brief cites and relies upon three cases, each of which certiorari has been granted by this court and in each case the petitioner dismissed voluntarily before there was a decision by the United States Supreme Court.

I

Three Cases in Which Certiorari Has Been Granted, Involving the Principal Question in This Petition.

The first case is that of *Kennedy v. Boston-Continental National Bank*, reported in 84 Fed.2d 592, in which certiorari was granted at 299 U.S. 533, and dis-

missed on motion of the petitioner's counsel in 300 U.S. 694. This petition appears in this court's records, No. 381 of October Term, 1936.

The petition for certiorari, filed September 21, 1936, in the Kennedy case states that there was a fifteen year lease at $12,000 a year in effect to the lessee national bank who defaulted in the covenant of rent on December 1, 1931. The bank ceased business on December 16, 1931, and the Comptroller took over on December 17th. Demand was made on January 8, 1932, giving notice of default and on January 13th the receiver notified the lessor of his election not to assume the lease. On August 18, 1932, the lessor made re-entry and declared the lease terminated under its terms and subsequently a claim was filed under the liquidated damage provisions of the lease which was allowed by the district court and reversed by the circuit court of appeals under the *Manhattan Property v. Irving Trust Co.* bankruptcy rule (291 U.S. 320). J. Morton dissented as the claim was under *Wm. Filene Sons Co. v. Weed* equity rule (245 U.S. 597). This petition in the Kennedy case sets forth the reason for the writ as the provability of the claim of a landlord for liquidated damage and the rule adopted by the C.C.A. was in conflict with the *Wm. Filene Sons* case (245 U.S. 597). This petition points out that the bankruptcy laws are not applicable to liquidation of national banks, citing *Cook County National Bank v. United States*, 107 U.S. 445; and *Gamble v. Wimberly*, 44 Fed.2d 329. While the National Bank Act is an exclusive method for liquidation of national banks, it merely lays down general rules for winding up affairs, and does not, as the Bankruptcy Act, establish a complete system of rules governing all phases of liquidation. The petition points out that this court has consistently applied the general principles

of equity for insolvent estates in national bank insolvencies and points out that Congress did not intend by the National Bank Act to impinge on contracts between creditors or debtors, or to destroy by implication any vested right at the time of suspension of the national bank; that all rights, legal or equitable, existing at the time of insolvency are preserved; and liens, equities or rights arising by express agreement or implication by nature of the dealings, were not to be invalidated.

The Kennedy petition for certiorari states that the National Bank Act contains no provision defining proveable claims or requiring that claims must have accrued and become unconditionally fixed on or before the time the bank became insolvent. *Sections 193* and *194* provide for the presentation of claims and the payment of dividends in the broadest terms known to the law and is entirely unrestricted. This petition cites *Merrill v. National Bank*, 173 U.S. 131 and at 134 quotes:

> "The requirement of equality of distribution among creditors by the national banking act involves no invasion of *prior contract rights* or any such creditors, and ought not to be construed as having or being intended to have, such a result." (italics ours)

The petition points out that the application of equitable principals requires the allowance of the landlord's claim for liquidated damages, citing the *Filene Sons* case, 245 U.S. 597, and pointing out the factual similarity between the two cases, and noting that the only difference was that the *Filene* case involved an equity bill for receivership while the *Kennedy* case involved a national bank under the Comptroller of the Currency. It points out that the *Filene Sons* decision was reversed by the

Supreme Court holding that for an insolvent estate in an equity receivership, there was no warrant to exclude creditors or introduce supposed equities other than those determined by contract between the creditors and the debtor; and that the creditor had a reasonable time before distribution is made to make his lawful claim and that the claim was proveable and held perfected by the re-entry and the terminating of the lease after the bill was filed, but damages were not presently payable until the re-entry. This *Kennedy* case petition points out that the breach occurred prior to the receivership (the rent being in default for seventeen days prior to the Comptroller's action) and that the lessor had a definite and contractual right based upon a contract made before the Comptroller took possession; that the lessor had at the time of the receivership an unquestioned right arising by express agreement, prior to insolvency, and not in contemplation thereof. The petition points out that the measure of damages was set forth in contract and its ultimate determination gave the claim its value on the date of insolvency and that this was a claim within the terms of the National Bank Act which cannot be taken away. (See *Chem. Nat'l. Bank v. Hartford Deposit Co.*, 161 U.S. 1.)

Respondent's brief cites and relies upon the case of *Boston-Continental National Bank v. Wendell Phillips Co.*, 84 Fed.2d 599, in which certiorari was granted by this court in *299 U.S. 533*, and the case was dismissed on motion of the petitioner's counsel at *300 U.S. 684*.

The petition for certiorari, upon which the writ was granted, appears in the record of case No. 382 of October 1936 term and it states that there was a ten year lease made to the bank and during the lease on December 17, 1931, the Comptroller closed the bank and on January 13, 1932, the receiver elected not to adopt

the lease. On March 30, 1932, the lessee vacated and the landlord on the same day terminated the lease which contained a covenant of indemnity for loss measured by the difference between the lease rental and the rental value for the balance of the term. This petition states that the question is whether the bankruptcy rule or the equitable rule shall apply to liquidation of national banks. It cites *12 U.S.C. 191-4*, the National Banking Act, as constituting a complete and statutory system for liquidation of national banks and distribution of assets. The petition points out that any provision for dividing claims into classes and cutting off contractual rights must be found in the statute itself. The petition states that neither the Bankrupcy Act nor the rules thereunder nor general statutory provisions giving the U.S. Government priorities in insolvency nor does state statutes classifying claims in insolvency proceedings are effective in national bank rceiverships, citing *Merrill v. Nat'l. Bank of Jacksonville*, 173 U.S. 131; *Cook Co. Nat'l. Bank v. U.S.*, 107 U.S. 445; and *Davis v. Elmira Savings Bank*, 161 U.S. 275. The National Bank Act contains no provisions defining claims that may presented or specifying contractual rights that are to be excluded from participating in the distribution of assets. *Section 194* provides for rateable distribution of money on all claims proved to the satisfaction of the Comptroller or adjudicated by a competent court. This means no creditor shall benefit at the expense of other creditors. The petition points out that in the lease the bank agreed by a distinct covenant not predicated on the leasehold, to pay damages in certain events. While it is true re-entry was made after insolvency, the contractual right to damages was a personal covenant, upon a footing that was familiar and fair. If the rateable dividend provision

is construed to cut off the landlord's pre-existing rights, the other creditors will benefit at the expense of the landlord whose rights are determined by the contract that the bank was content to make and the landlord to accept. The petition in the *Wendell Phillips* case points out that the court has construed the National Bank Act that it shall be administered in accordance with rules in equity, citing *Scott v. Armstrong*, 146 U.S. 499, and *Merrill v. Nat'l. Bank*, 173 U.S. 131, and that the circuit court of appeals by applying the bankruptcy rules disregarded these two decisions, the *Merrill* case and the *Scott* case.

Respondent's brief cites and relies upon *Dinan v. First National Bank*, 117 Fed.2d. 459. In this case certiorari was granted by the United States Supreme Court in 314 U.S. 593, and the case was dismissed on motion of petitioner's counsel in 315 U.S. 825. The petition in the *Dinan* case is in this court's records as Case No. 277 in the October term 1941 and states that the fundamental issue is whether the lessor has a right to establish his claim for damages for anticipatory breach of a lease by a national bank which had defaulted under its lease prior to the declaration of insolvency or the appointment of a conservator or receiver. It points out that Michigan creates a cause of action for damages very similar to that of California and which is set forth in *California Civil Code Section 3308* (pgs. 6 and 7, appendix). The *Dinan* petition points out that there was a liquidated damage provision in that bank lease very similar to the covenant of the lease, in the case at bar, set forth in petitioner's appendix, page 4. The *Dinan* petition raises the question that where the state law creates a cause of action for damages does the National Bank Act annul this cause of action in disregard of the state law? It raises a further question,

assuming that the National Bank Act is controlling, is there anything in that Act which in any way negates the right of the lessor to establish his claim in common with other creditors for breach of the lease? The *Dinan* petition also raises a third question, assuming the rule to be, as asserted by the court below, that the lessor's claim must exist at the time of appointment of the receiver, does a subsequent declaration of insolvency or appointment of a receiver operate as a bar to the already existing claim of the lessor so as to prevent him from sharing with other creditors of the bank? The *Dinan* petition sets forth a lease to the bank of $800 per month in which the rental last paid on February 1st and the payment due on March 1st was not paid. The bank closed with the bank holiday declared by the Governor and later by the President's bank holiday proclamation and did not re-open. Then on April 26th the conservator elected not to take possession and the Comptroller declared the bank insolvent on May 11th.

The *Dinan* petition cites the rule of *White v. Knox*, 111 U.S. 784, that the business of the bank must stop when the bank is declared insolvent by the Comptroller and that therefore no new debts can be contracted after that date and only a claim that originated in something done before the insolvency was a proper claim. The *Dinan* petition points out that in that case (as in the case at bar), there was a default in payment of rent antedating the declaration of insolvency and that the corporation still continued to exist and that Michigan by its law permits the lessor to recover damages upon the breach of the lease and that this is not in conflict with the federal rule, reciting *Chem. Nat'l. Bank v. Hartford Deposit Co.*, 161 U.S. 1; and *Int'l. Tr. Co. v. Weeks*, 203 U.S. 364. It is pointed out that the default of the lessee created a vested cause of action for

damages and arose out of an anticipatory breach. This petition points out there was nothing in the National Bank Act which prevents accrual of cause of action under local law by reason of the action of the bank prior to declaration of insolvency and the appointment of the receiver. That in the *Dinan* matter, the breach occurred by the failure to pay rent on March 1st and that the actual insolvency was declared by the Comptroller in May and that the landlord was entitled under Michigan law to recovery called for under application of the rule of *Erie Railroad Co. v. Tompkins*, 304 U.S. 64. This was a vested cause of action under Michigan law for damages for anticipatory breach and there is nothing in the National Bank Act, express or implied, which prevents action application of the *Erie Railroad* case. The *Dinan* petition points out that the breach of the lease by the bank preceeded the declaration of insolvency and the appointment of the receiver and that the subsequent declaration of insolvency did not relate back to the original closing of the bank by the Governor in February and cites and quotes from *Chem. Nat'l. Bank v. Hartford Deposit Co.*, 161 U.S. 1.

> "When insolvency is *declared* the corporation is incapacited from doing any new business. It has ceased to be a going firm, but it still survives for the purpose of the discharge of its liabilities and the final distribution of its remaining assets when that has been accomplished."

In the *Dinan* case, counsel for the Comptroller filed a reply brief and the petitioners filed their reply brief pointing out that the National Bank Act provided a comprehensive system for claims and for liquidation of closed banks, but nothing in it nullifies a cause of action arising under state law as a result of a breach of the lease or in contract or in tort committed prior to

Comptroller's declaration of insolvency and assumption of control. It points out that the right to share in distribution still exists, that the corporate entity still exists and that the bank is not released and the landlord's claim is enforceable against the assets of the bank.

We therefore have three decisions, and the principal three relied upon by the respondents, which in each case involved the same problems in this matter as the case at bar and in which certiorari was granted. In each of them the petitioners voluntarily dismissed the case, thus denying us the benefit of this court's decision of this important point of law.

It is interesting to note that in each of the three cases, the petitions cited *Chem. National Bank v. Hartford Deposit Co.*, 161 U.S. 1, where the Supreme Court upheld recovery on a lease where a national bank did go into receivership. In that case there was a re-entry by the landlord after the receiver was appointed and the Supreme Court held that the lessor was entitled to recover.

Respondent's brief cites *Buhl Land Company v. Kavanaugh*, 131 Fed. Supp. 136, as one of several cases having in them examples where the court has upheld the power of a receiver of a statutory national bank to disaffirm a lease and to lose the assets of a substantial amount without the approval of the court. We have reviewed the *Kennedy* case recited by respondent on page 7 and we have reviewed the *Wendell Phillips* case also cited, and also the *Dinan* case. The *Buhl Land Co.* case involved a suit for taxes claimed to be wrongfully assessed upon income of the plaintiff. The lessor had leased a building to a national bank that became insolvent and subsequently the taxpayer recovered $68,750 for future rents from the receiver, evidently under a liquidated damage clause as in the case at bar. The ques-

tion of taxation arose because the lessor had accrued the rents that he had not received for several years after the bank closed and during the pending litigation. The court held that as to these rents accrued and unpaid and in litigation they were not certain and therefore not includable in the landlord's income as accrued income and taxable as income until received.

Respondent's brief also cites *Fidelity Safe Deposit & Trust Company v. Armstrong*, 35 Fed. 567, decided by the circuit court in the Southern District of Ohio in 1888. It involved a lease to a bank in which the Comptroller obtained a decree cancelling the charter of the bank. The decision points out that with the bank no longer existing there was no lessee to sue and that the receiver took possession at a reduced rental.

We submit none of these authorities involve nor do they decide that a statutory receiver of a national bank has any power to dispose of assets of the bank, particularly by abandoning them and repudiating and further breaching a valid contract as in the case of the leasehold and leasehold improvements in the case at bar without consent of any court first had and obtained or without sale of the assets for a valuable consideration.

Nowhere in the National Bank Act or in any decision is there power given to the statutory receiver to breach valid and existing contracts in existence at the time the bank is declared insolvent nor to give away assets nor lose them or to prefer some creditors over others nor create classes of creditors nor to destroy vested rights existing by contract at the time of insolvency. Certainly the Comptroller or his statutory receiver has no right to invalidate vested contract rights.

II

Petitioner's Showing for Grounds for the Writ.

1. The circuit court decision where certiorari is asked, turns upon the *Kennedy* case, 84 Fed.2d 592, in which certiorari was granted. It also turned on the *Wendell Phillips* case, 64 Fed.2d 599, in which certiorari was granted. It cites the *Dinan* case in support of its holding, another decision in which certiorari was also granted.

2. All three of these cases involve the same issue, whether a liquidated damage clause in a lease is enforceable by the landlord against the assets of the bank, upon a contract made long prior to the declaration of insolvency or the appointment of a statutory receiver.

3. This decision of the 9th Circuit Court of Appeals is contrary to the *Wm. Filene Sons Co. v. Weed*, 245 U.S. 597, and *Gardner v. Butler & Co.*, 245 U.S. 603. A claim for damages by the landlord for breach of the lease was upheld in *Chem. Nat'l. Bank v. Hartford Deposit Co.*, 161 U.S. 1. The claim for damages under a valid lease accruing after the appointment of a judicial receiver is proveable in the receivership if it is liquidated before distributon of the assets by a judgment for damages, *Dickinson v. Universal Service Stations*, 9 Cir., 100 Fed.2d 753.

4. Executory contracts are breached by insolvency of a promisor under the doctrine of anticipatory breach, *Central Trust Co. v. Chicago Auditorium Theatre*, 240 U.S. 581; and anticipatory breaches are recognized in California law. *Caminetti v. Manierre*, 23 Cal.2d 94. See also *Leo v. Pearce Stores*, 54 Fed.2d 92, and cases therein cited.

In the case at bar the lease was breached by default in rent commencing December 1, 1964, almost two

months before the Comptroller closed the bank and appointed the statutory receiver. This breach has continued and no rent has been paid for January 1965 as well. The lease is to the San Francisco National Bank for general banking, trust and safe deposit purposes only (Par. 6 of lease, appendix pg. 3). The bank disabled itself and committed an anticipatory breach within *Central Tr. Co. v. Chicago Aud. Theatre* case (240 U.S. 581) by becoming insolvent and its financial affairs such that the Comptroller terminated this banking business.

5. *Manhattan Prop. v. Irving Tr.*, 291 U.S. 320, is not only a bankruptcy case not national bank or equitable insolvency case but one involving a covenant of indemnity as distinguished from a liquidated damage clause. (See Par. 15c of lease, appendix pg. 4, and Calif. *CC 3308*, app. pg. 6-7). The reasoning of the *Manhattan* case is that with a covenant of indemnity, a new cause of action arises only upon the breach to be indemnified and re-entry as distinguished from the liquidated damage clause which is a personal covenant created when the lease was contracted. This distinction is drawn and discussed in *Dickinson v. Universal Ser. Stations*, 9 Cir., 100 Fed.2d 753, granting recovery upon a lease involved in a judicial receivership.

6. The affidavits on summary judgment in the record in this case show that no rent was paid during December or during January, a total of $6,000. The court in face of this showing that there was a right to recover $6,000, etc., and a breach of the lease prior to the statutory receivership, erroneously granted summary judgment.

7. The statutory receiver appointed by the Comptroller for an insolvent national bank does not have the power to dispose of assets except in accordance

with the statute. He cannot breach contracts. He cannot lose the assets of the bank. He cannot repudiate a valid contract the bank was content to make and the lessor consented to.

We have not considered the effect of this court's granting of three writs of certiorari upon the doctrine of stare decisis and the weight to be given to those decisions cited in the circuit court of appeals' decision. We think that the fact certiorari has been granted on three separate occasions, and in each the plaintiff has dismissed the case before we have had the advantage of a decision, tends to show that there is a good reason to believe that the rule of law common in all three cases is subject to re-examination. It might be safely said that the fact the United States Supreme Court grants a petition for certiorari on three separate occasions in three separate cases all having the same question of law that there is a compelling reason to believe that four of the Justices in each occasion believed there was sufficient question of a sufficiently important problem to merit the consideration in each of the cases by this court. The fact that Congress has not seen fit to legislate on this point since any of these three cases that involved certiorari were decided would only tend to corroborate the view that the point of law is not yet established as claimed by respondent. It is still the law of the *Filene Sons* case, supra, *First National Bank of Chicago*, supra, etc., though somewhat in confusion by the decisions in which certiorari was granted, and now by the 9th Circuit decision for which this petition is pending.

Respondent contends that the decision of the 9th Circuit Court of Appeals is equitable. Any counsel having a decision of any court in his favor is, of course, inclined to believe that he has had justice for his client,

as he got what his client asked for. It is certainly not justice or equitable to take a contract which the bank saw fit to make and for the lessor to accept and to completely breach it and then obliterate the contractual rights. It is not fair or equitable to divide creditors into classes and to disregard one class of creditors and to distribute the bank's assets among another class of creditors, thus enriching one class unjustly instead of paying pro-rata as the bank statute requires. It is not equitable to grant the remedy in an equity receivership as in the *Wm. Filene* case, 245 U.S. 597, but to deny the same remedies in a statutory receivership of a national bank under the same factual situation when equitable principals are uniformly applied in bank insolvency proceedings. It is not equitable or fair to bar the plaintiffs by a dismissal with prejudice upon a motion for summary judgment when the affidavits show that there is unpaid and in default $6,000 in rent, all of which accrued prior to the Comptroller closing the bank or appointing his statutory receiver. It is not equitable or fair or even common sense to permit a statutory receiver to breach a valid and existing contract in existence long prior to the closing of the bank and to permit this statutory receiver to lose extensive property and leasehold improvements and to force upon a lessor the breach of his lease and the surrender of premises materially altered and far less valuable by reason of the alteration and integration into another building.

CONCLUSIONS

The questions raised by this case merit consid
tion by a writ of certiorari. We ask the writ issue

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